Part III. Administrative, Procedural, and Miscellaneous

Proposed Revenue Procedure Regarding Services That Qualify for the Student FICA Exception

Notice 2004–12

I. Overview and Purpose

This notice contains a proposed revenue procedure providing a safe harbor that certain institutions of higher education, and certain affiliated organizations can use in applying the exception for services performed by a student provided under § 3121(b)(10) of the Internal Revenue Code (student FICA exception). A previous version of this safe harbor was issued in Rev. Proc. 98–16, 1998–1 C.B. 403. However, the Service has recently proposed amendments to the Employment Tax Regulations interpreting § 3121(b)(10) in order to clarify specific issues that have arisen with taxpayers and in litigation (see proposed regulations § 31.3121(b)(10)–2(c), (d), and (e) published in the Federal Register on February 25, 2004 (REG–156421–03, 2004–10 I.R.B. 571 [69 F.R. 8604]). In order to provide guidance that is consistent with the proposed regulations in all respects, the Service is suspending Rev. Proc. 98–16 and proposing to replace it with the revenue procedure contained in this notice.

The proposed revenue procedure updates the safe harbor of Rev. Proc. 98–16 in several respects that align it with the proposed regulations. First, the proposed revenue procedure adds a primary function requirement to the definition of an institution of higher education. Section 3121(b)(10) applies only to services performed in the employ of a school, college, or university, or an affiliated § 509(a)(3) organization. Under the proposed regulations and the new safe harbor, an organization can be a school, college, or university only if its primary function is to conduct educational activities. Thus, in order to take advantage of the safe harbor in the revenue procedure, an institution must satisfy not only the Department of Education's regulations at 34 C.F.R. § 600.4 and satisfy the accreditation requirements of 34 C.F.R. § 600.2, as was required in Rev. Proc. 98–16, but also must have education and instruction as its primary function. The primary function requirement may make the exception under § 3121(b)(10) unavailable to certain institutions of higher education that are embedded within a larger organization like a hospital or museum.

Second, the proposed revenue procedure does not permit an institution to apply the student FICA exception to services performed by an employee who regularly works 40 or more hours per week. Under the existing regulations, services fall within the student FICA exception only if they are performed incident to and for the purpose of pursuing a course of study. The proposed regulations clarify that an individual who regularly works forty or more hours per week has the status of a career employee, and, accordingly, is not performing services incident to and for the purpose of pursuing a course of study. The proposed revenue procedure follows the proposed regulations. The student FICA exception generally, and the safe harbor provided by the proposed revenue procedure specifically, are still available for services performed by an employee who on occasion works 40 or more hours per week and otherwise meets the requirements of the safe harbor.

Third, the proposed revenue procedure provides that an individual has career employee status if the individual is a "professional employee." The proposed regulations provide that a professional employee for purposes of the student FICA exception is an employee whose primary duty consists of the performance of services requiring knowledge of an advanced type in a field of science or learning, whose work requires the consistent exercise of discretion and judgment in its performance, and whose work is predominantly intellectual and varied in character. The proposed revenue procedure follows the proposed regulations.

Fourth, the proposed revenue procedure expands the terms of employment that result in status as a career employee. Rev. Proc. 98–16 provided that an individual was to be considered a career employee if the employee was eligible to participate in one of several types of retirement plans, eligible for reduced tuition (with certain exceptions), or otherwise classified by the institution of higher education as a career employee. The proposed regulations adopt the same criteria for identifying individuals who have the status of a career employee and adds to the list eligibility for a number of other benefits. The proposed revenue procedure follows the proposed regulations, adding the additional criteria that cause an individual to have career employee status and fall outside the scope of the safe harbor. Employees considered as having the status of a career employee *per se* cannot have the status of a student for purposes of the student FICA exception.

Fifth, and finally, the proposed revenue procedure provides that an employee has career employee status if the individual is required to be licensed under state or local law in order to perform the services the individual provides to the school, college, or university. The proposed revenue procedure follows the proposed regulation.

II. Request for Comments

Comments are requested on the proposed revenue procedure. Comments may be submitted on or before May 25, 2004, to Internal Revenue Service, PO Box 7604, Washington, DC 20044, Attn: CC:PA:LPD:PR (Notice 2004–12), Room 5203. Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at 1111 Constitution Avenue, NW, Washington, DC 20224, Attn: CC:PA:LPD:PR (Notice 2004–12), Room 5203. Submissions may also be sent electronically via the internet to the following email address: *Notice.comments@irscounsel.treas.gov*. Include the notice number (Notice 2004–12) in the subject line.

III. Effect on Other Documents

Rev. Proc. 98–16 is suspended effective February 25, 2004.

IV. Effective Date

The Service intends to issue a final revenue procedure at the same time that the

proposed regulations under § 3121(b)(10) are finalized. Until a final version of the proposed revenue procedure is issued, taxpayers may rely on the proposed revenue procedure with respect to services performed on or after February 25, 2004 (the date prop. Reg. § 31.3121(b)(10)–2(c)–(f) (69 F.R. 8604) was published in the Federal Register).

V. Proposed Revenue Procedure

SECTION 1. PURPOSE

This revenue procedure sets forth generally applicable standards for determining whether service in the employ of certain public or private nonprofit schools, colleges, universities, or affiliated organizations described in § 509(a)(3) of the Internal Revenue Code (the Code) performed by a student qualifies for the exception from Federal Insurance Contributions Act (FICA) tax provided under § 3121(b)(10) of the Code (Student FICA exception). These standards are intended to provide objective and administrable guidelines for determining employment tax liability.

SECTION 2. SCOPE

.01 Institutions of higher education typically distinguish between career employees and student employees. Sections 5 and 6 of this revenue procedure contain generally applicable standards for determining whether or not services performed by employees of certain institutions of higher education are eligible for the Student FICA exception.

.02 The standards contained in this revenue procedure do not apply to employees who are postdoctoral students, postdoctoral fellows, medical residents, or medical interns because the services performed by these employees cannot be assumed to be incident to and for the purpose of pursuing a course of study. The employment activities of these individuals overlaps with the activities comprising the course of study, and thus it is not appropriate to apply the standards of this revenue procedure to these individuals.

.03 The standards contained in this revenue procedure may not constitute the exclusive method for determining whether the Student FICA exception applies. If the standard for qualifying for the exclusion described in section 6 of this revenue procedure (providing generally that an employee enrolled at least half-time at an institution of higher education has the status of student) is not met, whether or not service in the employ of a school, college, university, or affiliated organization described in § 509(a)(3) of the Code will qualify for the Student FICA exception will depend on consideration of all the facts and circumstances.

SECTION 3. BACKGROUND

.01 Sections 3101 and 3111 of the Code impose social security and Medicare taxes (FICA taxes) on employees and employers, respectively, equal to a percentage of the wages received by an individual with respect to employment.

.02 Section 3121(a) of the Code defines "wages" for purposes of FICA taxes as all remuneration for employment, with certain exceptions. Section 3121(b) of the Code defines "employment" as services performed by an employee for an employer, with certain exceptions.

.03 Section 3121(b)(10) of the Code excepts from the definition of employment services performed in the employ of a school, college, or university (whether or not that organization is exempt from income tax), or an affiliated organization described in § 509(a)(3) of the Code, if the services are performed by a student who is enrolled and regularly attending classes at that school, college, or university. Remuneration for services excluded from the definition of employment under § 3121(b)(10) of the Code is not subject to FICA taxes.

.04 Section 31.3121(b)(10)–2 of the Employment Tax Regulations provides that whether an employee has the status of a student is determined on the basis of the employee's relationship with the school, college, or university for which the services are being performed. An employee who performs services in the employ of a school, college, or university as an incident to and for the purpose of pursuing a course of study at the school, college, or university has the status of a student in the performance of those services. Services that are not incident to and for the purpose of pursuing a course of study do not qualify for the exception. If the employee performs services as an incident to and for the purpose of pursuing a course of study and, therefore, has the status of a student, the amount of remuneration for services performed by the employee, the type of services performed by the employee, and the place where the services are performed are immaterial for purposes of the Student FICA exception.

.05 Section 218 of the Social Security Act (the Act), 42 U.S.C. section 418, allows states to provide Social Security coverage for services performed by students for the public school the student is attending under agreements established with the Social Security Administration. If a state has exercised its option under § 218 of the Act to provide for coverage of student services, § 3121(b)(10) of the Code provides that those services will not qualify for the Student FICA exception.

SECTION 4. CERTAIN INSTITUTIONS OF HIGHER EDUCATION

.01 The standards contained in this revenue procedure apply to "institutions of higher education" meeting the requirements of § 31.3121(b)(10)–2(c) of the proposed Employment Tax Regulations. For purposes of this revenue procedure, the term "institution of higher education" includes any public or private nonprofit school, college, or university within the meaning of prop. Reg. § 31.3121(b)(10)–2(c), or affiliated organization described in § 509(a)(3) of the Code, that meets the requirements set forth in Department of Education regulations at 34 C.F.R. § 600.4, as amended from time to time, and that is accredited or preaccredited by a nationally recognized accrediting agency as defined in the Department of Education regulations at 34 C.F.R. § 600.2.

.02 Services for other institutions may also be eligible for the Student FICA exception. Thus, for example, services performed by a student for a secondary school may be eligible for the Student FICA exception. Whether or not services for other institutions, such as secondary schools, qualify for the Student FICA exception is determined based on the facts and circumstances of each case.

SECTION 5. STUDENT FICA EXCEPTION NOT AVAILABLE FOR EMPLOYEES WITH CAREER EMPLOYEE STATUS

.01 Services performed by individuals with career employee status are not eligible for the Student FICA exception under the standard in section 6 of this revenue procedure because their services are not incident to and for the purpose of pursuing a course of study. See prop. Reg. § 31.3121(b)(10)–2(d)(3)(ii).

.02 Career employee status. Services of an employee with career employee status are not incident to and for the purpose of pursuing a course of study. An employee may be considered to have career employee status based on the employee's hours worked, whether the employee is a "professional employee," the employee's terms of employment, or whether the employee is licensed under state or local law to work in the field in which the employee performs services. These standards are set forth in prop. Reg. § 31.3121(b)(10)–2(d)(3)(ii). An employee has career employee status if the employee is described in paragraph (1), (2), (3), or (4) of this section.

(1) Hours worked. An employee has the status of a career employee if the employee regularly performs services 40 hours or more per week.

(2) Professional employee. An employee has the status of a career employee if the employee is a professional employee. A professional employee is an employee—

(a) Whose primary duty consists of the performance of work requiring knowledge of an advanced type in a field of science or learning customarily acquired by a prolonged course of specialized intellectual instruction and study, as distinguished from a general academic education, from an apprenticeship, and from training in the performance of routine mental, manual, or physical processes.

(b) Whose work requires the consistent exercise of discretion and judgment in its performance; and

(c) Whose work is predominantly intellectual and varied in character (as opposed to routine mental, manual, mechanical, or physical work) and is of such character that the output produced or the result accomplished cannot be standardized in relation to a given period of time.

(3) Terms of employment. An employee's terms of employment may indicate that the employee has career employee status. An employee with career employee status includes any employee who is—

(a) Eligible to receive vacation, sick leave, or paid holiday benefits;

(b) Eligible to participate in any retirement plan described in § 401(a) of the Code that is established or maintained by the employer; or would be eligible to participate if age and service requirements were met;

(c) Eligible to participate in an arrangement described in § 403(b) of the Code, or would be eligible to participate if age and service requirements were met;

(d) Eligible to participate in a plan described under § 457(a), or would be eligible to participate if age and service requirements were met;

(e) Eligible for reduced tuition (other than qualified tuition reduction under § 117(d)(5) of the Code provided to a teaching or research assistant who is a graduate student) because of the individual's employment relationship with the institution;

(f) Eligible to receive employee benefits described under § 79 (life insurance), 127 (qualified educational assistance), 129 (dependent care assistance programs), or 137 (adoption assistance); or

(g) Classified by the employer as a career employee.

(4) *Licensure*. An employee is a career employee if the employee is required to be licensed under state or local law to work in the field in which the employee performs services.

.03 If an individual performs services in multiple job positions, the individual will be deemed to have career employee status with respect to all of the positions if the individual has career employee status in any one or more of the job positions.

SECTION 6. STANDARDS APPLICABLE TO UNDERGRADUATE AND GRADUATE STUDENTS

.01 An individual who is a half-time undergraduate student or a half-time graduate or professional student and who does not have the status of a career employee will qualify for the Student FICA exception under this revenue procedure with respect to services performed at or for an institution of higher education described in section 4 of this revenue procedure in which they are enrolled or at affiliated organizations described in § 509(a)(3) of the Code. Services performed by a student for any other employer are not covered by the standards of this revenue procedure.

.02 An individual is deemed to be a half-time undergraduate or half-time graduate or professional student if the individual does not have the status of a career employee status and is an undergraduate or graduate student who is in the last semester, trimester, or quarter of a course of study requiring at least two semesters, trimesters, or quarters to complete and is enrolled in the number of credit or unit hours needed to complete the requirements for obtaining a degree, certificate, or other recognized educational credential offered by that institution of higher education even if enrolled in less than half the number required of full-time students.

.03 The determination of student status should be made at the end of the drop-add period and may be adjusted thereafter at the institution of higher education's option. The determination of student status for payroll periods ending before the end of the drop-add period may be based on the number of semester, trimester, or quarter hours being taken at the end of the registration period for that semester, trimester, or quarter.

.04 If an individual is described in section 6.01 or 6.02 of this revenue procedure, services performed by the individual are eligible for the Student FICA exception with respect to all services performed during all payroll periods of a month or less that fall wholly or partially within the academic term.

.05 The Student FICA exception does not apply to services performed by an individual who is not enrolled in classes during school breaks of more than five weeks (including summer breaks of more than five weeks), other than services described in section 6.04. See Rev. Rul. 72–142, 1972–1 C.B. 317, and Rev. Rul. 74–109, 1974–1 C.B. 288. However, the Student FICA exception applies to employment which continues during normal school breaks of 5 weeks or less during which the individual is not eligible for

the Student FICA exception pursuant to section 6.01 of this revenue procedure provided that the individual qualifies for the Student FICA exception pursuant to section 6.01 of this revenue procedure on the last day of classes or examinations preceding the break and is eligible to enroll in classes for the first academic period following the break.

.06 If the standards of this revenue procedure are met (and section 8 does not apply), the amount of remuneration for services performed by the employee, the type of services performed by the employee, and the place where the services are performed are immaterial. If the services performed by a student otherwise described in section 6.01 or 6.02 are covered under an agreement pursuant to section 218 of the Act, the Student FICA exception does not apply.

.07 For provisions relating to domestic service performed by a student in a local college club, or local chapter of a college fraternity or sorority, see § 31.3121(b)(2)–1.

SECTION 7. DEFINITIONS

For purposes of the standard contained in section 6 of this revenue procedure, the following definitions must be used. For purposes of the following definitions, the term "institution of higher education" means an institution of higher education as defined in section 4 of this revenue procedure.

.01 Undergraduate student. The term "undergraduate student" has the meaning attributed to that term in the Department of Education regulations at 34 C.F.R. section 674.2.

.02 Half-time undergraduate student. The term "half-time undergraduate student" has the meaning attributed to that term in the Department of Education regulations at 34 C.F.R. section 674.2.

.03 Graduate or professional student. The term "graduate or professional student" means a student who—

(1) is enrolled at an institution of higher education for the purpose of obtaining a degree, certificate, or other recognized educational credential above the baccalaureate level or is enrolled in a program leading to a professional degree;

(2) has completed the equivalent of at least three years of full-time study at an institution of higher education, either prior to entrance into the program or as part of the program itself; and

(3) is not a postdoctoral student, postdoctoral fellow, medical resident, or medical intern.

.04 Half-time graduate or professional student. The term "half-time graduate or professional student" means an enrolled graduate or professional student, as defined in section 7.03 of this revenue procedure, who is carrying at least a half-time academic workload at an institution of higher education as determined by that institution according to its own standards and practices.

SECTION 8. ANTI-ABUSE RULE

The standards in this revenue procedure must be applied in a reasonable manner, consistent with the purpose of excluding from employment only services that are performed as an incident to and for the purpose of pursuing a course of study at an institution of higher education as defined in section 4 of this revenue procedure. If the standards are inappropriately applied in a manner that conflicts with this underlying purpose so as to manipulate or mischaracterize the nature of the relationship between an employee and an institution of higher education, resulting in the improper avoidance of payment of FICA taxes, then whether the Student FICA exception applies will be determined on the basis of all the facts and circumstances, rather than on the basis of the specific standards set forth in section 6 of this revenue procedure. For example, the standards would be inappropriately applied through the manipulation of the relationship between employees and the institution of higher education if a university claimed that the Student FICA exception applied to research laboratory workers, who had been career employees, but were converted to non-career status and required to enroll in a certificate program granting six credit hours per semester for work experience in the laboratory. As another example, if an individual who was not a student worked for a university on a full-time basis for many years, in a job generally performed by non-students (but nonetheless failed to meet the literal definition of career employee), and then enrolled at the university for six credit hours of course work per semester while continuing the full-time work in the same job, it may not be appropriate to apply the standards of this revenue procedure to conclude that the individual's work has become incident to and for the purpose of pursuing a course of study solely because the individual enrolled for this course work. In both of these examples, whether the work is performed incident to and for the purpose of pursuing a course of study must be determined on the basis of all the relevant facts and circumstances.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for services performed on or after February 25, 2004 (the date prop. Reg. § 31.3121(b)(10)–2(c)–(f) (69 FR 8604) was published in the Federal Register).

The principal author of this notice is Stephen D. Suetterlein of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). However, other personnel from the Service and Treasury Department participated in the development of this notice. For further information regarding this notice, contact Mr. Suetterlein at (202) 622–6040 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters. (Also, Part I, § 402; § 1.402(a)–1.)

Rev. Proc. 2004–16

SECTION 1. PURPOSE

This revenue procedure is issued in connection with the issuance of proposed regulations under § 402(a) of the Internal Revenue Code regarding the valuation of life insurance contracts upon distribution from a qualified retirement plan and proposed regulations under §§ 79 and 83 regarding the valuation of life insurance contracts under those sections (REG–126967–03, 2004–10 I.R.B. 566). The preamble to the proposed regulations states that it is not appropriate in some cases to use either the net surrender value of a distributed life insurance contract (*i.e.*, the contract's cash value after reduction for any surrender charges) or the contract's reserves as the contract's fair

market value upon distribution of an insurance contract from a qualified plan but the preamble provides limited guidance as to what value may be used instead. Similarly, the proposed regulations under §§ 79 and 83 clarify that the amount includible in income under those sections is based upon the fair market value of the insurance contract rather than its cash value but these proposed regulations do not provide any guidance as what constitutes fair market value. The regulations are generally proposed to apply beginning on the date the proposed regulations are filed in the Federal Register. The preamble to the proposed regulations also requests public comments regarding appropriate methods for valuing life insurance contracts when distributed from qualified retirement plans and for purposes of §§ 79 and 83. Until further guidance is issued, this revenue procedure provides interim rules under which the cash value (without reduction for surrender charges) of a life insurance contract may be treated as the contract's fair market value when the contract is distributed from a qualified plan under § 402 and for purposes of §§ 79 and 83.

SECTION 2. BACKGROUND

.01 Section 402(a) provides generally that any amount actually distributed to any distributee by any employees' trust described in § 401(a) which is exempt from tax under § 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under § 72.

.02 Section 1.402(a)–1(a)(*1*)(iii) of the current regulations provides, in general, that a distribution of property by a § 401(a) plan shall be taken into account by the distributee at its "fair market value." Section 1.402(a)–1(a)(2) of the current regulations provides, in general, that upon distribution of an annuity or life insurance contract, the "entire cash value" must be included in the distributee's income. The current regulations do not define "fair market value" or "entire cash value" and questions have arisen regarding the interaction between these two provisions.

.03 The proposed regulations would clarify that the requirement that a distribution of property must be included in the distributee's income at fair market value is controlling in those situations where the existing regulations provide for the inclusion of the entire cash value. Thus, the proposed regulations provide that, in those cases where a qualified plan distributes a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, the fair market value of such a contract is generally included in the distributee's income rather than the entire cash value of the contract. For this purpose, the policy cash value and all other rights under the contract (including any supplemental agreements thereto and whether or not guaranteed) are included in determining the fair market value of such a contract. The proposed regulations provide a similar rule for purposes of the valuation of such contracts under §§ 79 and 83.

.04 In Rev. Rul. 59–195, 1959–1 C.B. 18, the Service ruled that in situations similar to those where an employer purchases and pays the premiums on an insurance policy on the life of one of its employees and subsequently sells such policy, on which further premiums must be paid, the value of such policy, for computing taxable gain in the year of purchase, should be determined under the method of valuation prescribed in § 25.2512–6 of the Gift Tax Regulations. Under this method, the value of such a policy is not its cash surrender value but the interpolated terminal reserve at the date of sale plus the proportionate part of any premium paid by the employer prior to the date of the sale which is applicable to a period subsequent to the date of the sale. Section 25.2512–6 also provides that if "because of the unusual nature of the contract such approximation is not reasonably close to the full value, this method may not be used." Thus, this method may not be used to determine the fair market value of an insurance policy where the reserve does not reflect the value of all of the relevant features of the policy.

.05 In Q&A–10 of Notice 89–25, 1989–1 C.B. 662, the IRS addressed the question of what amount is includible in income under § 402(a) when a participant receives a distribution from a qualified plan that includes a life insurance policy with a value substantially higher than the cash surrender value stated in the policy. The notice noted the practice of using cash surrender value as fair market value for these purposes and concluded that this practice is not appropriate where the total policy reserves, including life insurance reserves (if any) computed under § 807(d), together with any reserves for advance premiums, dividend accumulations, etc., represent a much more accurate approximation of the policy's fair market value.

.06 Since Notice 89–25 was issued, life insurance contracts have been marketed that are structured in a manner which results in a temporary period during which neither a contract's reserves nor its cash surrender value represent the fair market value of the contract. For example, some life insurance contracts may provide for large surrender charges and other charges that are not expected to be paid because they are expected to be eliminated or reversed in the future (under the contract or under another contract for which the first contract is exchanged), but this future elimination or reversal is not always reflected in the calculation of the contract's reserve. If such a contract is distributed prior to the elimination or reversal of those charges, both the cash surrender value and the reserve under the contract could significantly understate the fair market value of the contract. Thus, the preamble to the proposed regulations states that, in some cases, it would not be appropriate to use either the net surrender value (*i.e.* the contract's cash value after reduction for any surrender charges) or, because of the unusual nature of the contract, the contract's reserves to determine the fair market value of the contract. Accordingly, Q&A–10 of Notice 89–25 should not be interpreted to provide that a contract's reserves (including life insurance reserves (if any) computed under § 807(d), together with any reserves for advance premiums, dividend accumulations, etc.) are always an accurate representation of the contract's fair market value.

.07 As stated in the preamble to the proposed regulations, the amount of any distribution determined under § 402 also applies for purposes of determining the qualified status of any plan. For example, the fair market value of a distributed life insurance contract, determined in accordance with the proposed regulations and this revenue procedure, must be considered in determining whether the insured participant has received benefits in excess of the limits imposed by § 415.

.08 Section 79 generally requires that the cost of group-term life insurance coverage on the life of an employee that is in excess of $50,000 of coverage be included in the income of the employee. Pursuant to § 1.79–1(b) of the Income Tax Regulations, under specified circumstances group-term life insurance may be combined with other benefits, referred to as permanent benefits.

.09 Permanent benefits provided to an employee are subject to taxation under rules described in § 1.79–1(d). Under those rules, the cost of the permanent benefits, reduced by the amount paid for those benefits by the employee, is included in the employee's income. The cost of the benefits can be no less than an amount determined under a formula provided in the regulations. The formula is based in part on the increase in the employee's deemed death benefit during the year. One of the factors used for determining the deemed death benefit is "the net level premium reserve at the end of that policy year for all benefits provided to the employee by the policy or, if greater, the cash value of the policy at the end of that policy year."

.10 The proposed regulations would amend § 1.79–1(d) to delete the term cash value from the formula for determining the cost of permanent benefits and substitute the term fair market value. The purpose of the change is to clarify that, unless specifically excepted from the definition of permanent benefits, the value of all features of a life insurance policy providing an economic benefit to an employee (including, for example, the value of a springing cash value feature) must be included in the employee's income.

.11 Section 83(a) provides that when property is transferred to any person in connection with the performance of services, the service provider must include in gross income (as compensation income) the excess of the fair market value of the property, determined without regard to lapse restrictions (such as life insurance contract surrender charges), and determined at the first time that the transferee's rights in the property are either transferable or not subject to a substantial risk of forfeiture (*i.e.*, when those rights become "substantially vested"), over the amount (if any) paid for the property. Section 1.83–3(e) provides that in the case of a transfer of a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, only the cash surrender value of the contract is considered to be property. The proposed regulations generally would amend § 1.83–3(e) to provide that in the case of a transfer of an insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, the policy cash value and all other rights under the contract (including any supplemental agreements, whether or not guaranteed), other than current insurance protection, are treated as property for purposes of this section. However, in the case of the transfer of a life insurance contract, retirement income contract, endowment contract, or other contract providing life insurance protection, which was part of a split-dollar arrangement (as defined in § 1.61–22(j)) entered into on or before September 17, 2003, and which is not materially modified (as defined in § 1.61–22(j)(2)) after September 17, 2003, only the cash surrender value of the contract is considered to be property.

SECTION 3. INTERIM GUIDANCE FOR DETERMINING FAIR MARKET VALUE

.01 The Service and the Treasury recognize that many taxpayers could have difficulty determining the fair market value of an insurance contract after the issuance of the proposed regulations under §§ 79 and 83 and the clarification in the preamble to the proposed regulations under § 402 that Notice 89–25 should not be interpreted to provide that a contract's reserves (including life insurance reserves (if any) computed under § 807(d), together with any reserves for advance premiums, dividend accumulations, etc.) are always an accurate representation of the contract's fair market value. Accordingly, in connection with the proposed regulations, this revenue procedure provides interim rules under which the cash value (without reduction for surrender charges) of a life insurance contract distributed from a qualified plan may be treated as the fair market value of that contract. These interim rules also apply for purposes of determining the value of insurance contracts under §§ 79 and 83.

.02 Cash value (without reduction for surrender charges) may be treated as the fair market value of a contract as of a determination date provided such cash value is at least as large as the aggregate of: (1) the premiums paid from the date of issue through the date of determination, plus (2) any amounts credited (or otherwise made available) to the policyholder with respect to those premiums, including interest, dividends, and similar income items (whether under the contract or otherwise), minus (3) reasonable mortality charges and reasonable charges (other than mortality charges), but only if those charges are actually charged on or before the date of determination and are expected to be paid.

.03 In those cases where the contract is a variable contract (as defined in § 817(d)) cash value (without reduction for surrender charges) may be treated as the fair market value of the contract provided such cash value is at least as large as the aggregate of: (1) the premiums paid from the date of issue through the date of determination, plus (2) all adjustments made with respect to those premiums during that period (whether under the contract or otherwise) that reflect investment return and the current market value of segregated asset accounts, minus (3) reasonable mortality charges and reasonable charges (other than mortality charges), but only if those charges are actually charged on or before the date of determination and are expected to be paid.

.04 The date of determination in the case of a distribution of a contract from a qualified plan is the date of that distribution. The date of determination in the case of the provision of permanent benefits subject to § 79 is the date those benefits are provided. The date of determination in the case of a transfer of an insurance contract subject to § 83 is the date on which fair market value must be determined under the rules of § 83.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective on February 13, 2004.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Robert Walsh and Larry Isaacs of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding

this revenue procedure as it pertains to § 402, please contact the Employee Plans' taxpayer assistance telephone service at 1–877–829–5500 (a toll-free number) between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday. For further information regarding this revenue procedure as it pertains to § 79, please contact Betty Clary of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622–6080 (not a toll-free number). For further information regarding this revenue procedure as it pertains to § 83, please contact Robert Misner of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622–6030 (not a toll-free number). Mr. Walsh and Mr. Isaacs may be reached at (202) 283–9888 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also, Part I, § 911, 1.911–1.)

Rev. Proc. 2004–17

SECTION 1. PURPOSE

.01 This revenue procedure provides information to any individual who failed to meet the eligibility requirements of § 911(d)(1) of the Internal Revenue Code because adverse conditions in a foreign country precluded the individual from meeting those requirements for taxable year 2003.

.02 The Internal Revenue Service has previously listed countries for which the eligibility requirements of § 911(d)(1) of the Code are waived under § 911(d)(4) because of adverse conditions in those countries on and after the date stated. See Rev. Proc. 2003–26, 2003–1 C.B. 666, Rev. Proc. 2002–20, 2002–1 C.B. 732, and Rev. Proc. 2001–27, 2001–1 C.B. 1155. This revenue procedure lists countries added to the list in 2003, for which the eligibility requirements of § 911(d)(1) are waived. Rev. Proc. 2003–26, Rev. Proc. 2002–20, and Rev. Proc. 2001–27 remain in full force and effect.

SECTION 2. BACKGROUND

.01 Section 911(a) of the Code allows a "qualified individual," as defined in § 911(d)(1), to exclude foreign earned income and housing cost amounts from gross income. Section 911(c)(3) of the Code allows a qualified individual to deduct housing cost amounts from gross income.

.02 Section 911(d)(1) of the Code defines the term "qualified individual" as an individual whose tax home is in a foreign country and who is (A) a citizen of the United States and establishes to the satisfaction of the Secretary of the Treasury that the individual has been a *bona fide* resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year, or (B) a citizen or resident of the United States who, during any period of 12 consecutive months, is present in a foreign country or countries during at least 330 full days.

.03 Section 911(d)(4) of the Code provides an exception to the eligibility requirements of § 911(d)(1). An individual will be treated as a qualified individual with respect to a period in which the individual was a *bona fide* resident of, or was present in, a foreign country if the individual left the country during a period for which the Secretary of the Treasury, after consultation with the Secretary of State, determines that individuals were required to leave because of war, civil unrest, or similar adverse conditions that precluded the normal conduct of business. An individual must establish that but for those conditions the individual could reasonably have been expected to meet the eligibility requirements.

.04 For 2003, the Secretary of the Treasury in consultation with the Secretary of State has determined that war, civil unrest, or similar adverse conditions that precluded the normal conduct of business existed in the following countries beginning on the specified date:

	Date of Departure
Country	*On or after*
Burundi	July 13, 2003
Israel	March 16, 2003
Kuwait	March 16, 2003
Liberia	June 6, 2003
Saudi Arabia	May 13, 2003
Syria	March 16, 2003

.05 Accordingly, for purposes of § 911 of the Code, an individual who left one of the foregoing countries on or after the specified departure date shall be treated as a qualified individual with respect to the period during which that individual was present in, or was a *bona fide* resident of, such foreign country, if the individual establishes a reasonable expectation of meeting the requirements of § 911(d) but for those conditions.

.06 To qualify for relief under § 911(d)(4) of the Code, an individual must have established residency, or have been physically present, in the foreign country on or prior to the date that the Secretary of the Treasury determines that individuals were required to leave the foreign country. Individuals who establish residency, or are first physically present, in the foreign country after the date that the Secretary prescribes shall not be treated as qualified individuals under § 911(d)(4) of the Code. For example, individuals who are first physically present in Kuwait after March 16, 2003, are not eligible to qualify for the exception provided in § 911(d)(4) of the Code for taxable year 2003.